HOUSE AG COMMITTEE HEARING

OVERVIEW

For questions on the note below, please contact Scott Parsons or Edmund Perry at (202) 547-3035.

Today, the House Agriculture Committee held a hearing entitled "The Future of Digital Assets: Providing Clarity for Digital Asset Spot Markets." The witnesses in the hearing were:

- Panel I
  - Rostin Behnam, Chairman, Commodity Futures Trading Commission (CFTC)
- Panel II
  - Christopher Giancarlo, Former Chairman, CFTC
  - Paul Grewal, Chief Legal Officer, Coinbase
  - Dan Gallagher, Chief Legal Compliance Officer, Robinhood, Former Commissioner, Securities and Exchange Commission (SEC)
  - Dan Berkovitz, Former Commissioner, CFTC, Former General Council, SEC
  - Walt Lukken, President and CEO, Futures Industry Association (FIA), Former Acting Chairman, CFTC

Below is a summary of the hearing prepared by Delta Strategy Group. It includes several high-level takeaways from both panels, followed by summaries of opening statements and witness testimonies and a summary of the Q&A portion of the hearing.

Key Takeaways

The following is a summary of some of the topics explored in today's hearing. Each is discussed in further detail in the Discussion section below.

- Chairman GT Thompson (R-PA)

    - The legislation introduced last week will provide certainty and install new consumer protections, but we are still working and taking feedback on the legislation. We cannot continue to allow regulation by enforcement to be the prevailing way we treat these markets.

- Ranking Member David Scott (D-GA)

    - This legislation does not create the appropriate funding mechanisms for the CFTC. If the CFTC is not given additional funding, it will not be able to handle these new markets in an efficient way that protects investors. The provisional registration process described in this bill that would take place while the CFTC and SEC work on joint rulemakings seems confusing and has the potential to allow something to fall between regulatory cracks.

- CFTC Chairman Rostin Behnam

- The CFTC is well-suited to take on digital asset commodity markets. Because we are a principles-based regulator with a mandate to promote innovation, we are positioned well to be flexible and encourage innovation while still ensuring that markets are transparent, orderly, and safe for investors. We proved this when Congress gave us additional authority over swaps markets.
- We know that the vast majority of trading in digital assets is on bitcoin and ether. Bitcoin has been unquestionably established as a commodity, and I have been vocal in the past that I believe ether is a commodity. The CFTC conducted significant reviews of ether when the first ether-based futures contracts were listed and found that it is a commodity.
- The CFTC would require about $120 million in additional funding over three years to take on these new markets. Recent proposals to cut our budget would devastate our ability to continue regulating even the markets currently under our jurisdiction.
- This bill is foundationally strong, and the way that it draws from current CFTC regulations would create an effective regulatory environment for digital assets, but there are some places to consider change. Without an additional funding mechanism, the joint rulemaking process might take up to four years to compete, which could create problems with the provisional registration process. Congress should also consider inserting studies into financial inclusion and climate concerns into this bill.

- Walt Lukken, President and CEO, FIA

    - Principles-based regulation is appropriate to allow innovation to take place in digital asset markets, but the CFTC is not a light-touch regulator, and it will bring significant regulatory controls to these markets.

PANEL I SUMMARY

Opening Statements and Testimony

Chairman GT Thompson (R-PA)

Blockchain has the potential to transform everyday life for Americans. It is vital that we implement appropriate guardrails for digital asset markets to ensure that we maintain the same customer protections that are found in traditional markets. I am grateful for the collaboration we have enjoyed with the House Financial Services Committee and Chairman Patrick McHenry (R-NC).

The current federal laws and regulations provide few rules to the road leading to complicated enforcement actions by regulators that only serve to create more market confusion. The discussion draft we have just released intends to provide certainty, bolster innovation, and install consumer protections, but this is still just a draft, and hearings like this will help us refine and improve it. Regulation by enforcement will simply not provide an appropriate framework for consumers or innovators in this space.

Ranking Member David Scott (D-GA)

I have always fought to bring more resources to the CFTC, and I believe that increasing funding is more important than ever. CFTC markets are ever evolving, and the CFTC must have sufficient resources to evolve with them. This draft legislation establishes a number of complex and untested processes for the CFTC without providing these necessary resources. It is unclear whether this will create real clarity for the industry. The provisional registration process described in this bill that would take place while the

CFTC and SEC work on joint rulemakings seems confusing and has the potential to allow something to fall between regulatory cracks.

These markets pose significant potential risks and uncertainties for financial markets. Digital commodity spot markets are operated according to an ill-suited regulatory regime that varies substantially based on the states in which these trading platforms operate. That alone highlights the depth of the issue we are facing.

Rostin Behnam, Chairman, CFTC

Since my confirmation, I have called for Congressional guidance for digital commodity markets to bring it out of the shadows and into the regulatory fold. This has been echoed by other regulatory bodies such as the Financial Stability Oversight Council (FSOC). Events like the FTX failure only further highlighted this need. Leaving billions of dollars in largely unregulated entities is a recipe for disaster.

Following the financial crisis, this Committee helped establish clear reforms to the swaps market that were anchored in core principles of sound market regulation: transparency, reporting, and registration. These tools are necessary to prevent future crises. We saw that one of the only parts of FTX to survive its collapse was its CFTC-registered entity.

I am encouraged by the continued interest of both parties in Congress and the administration to address the regulatory gap over digital commodities, and generally support legislative efforts by this Committee to provide the CFTC with additional authorities to do just that. That said, it is critically important that any new bills introduced in Congress do not undermine existing laws. Most notably, where securities laws apply, the SEC should use its robust authorities to protect customers and address information gaps. Congress must ensure that the CFTC is fully empowered to require registered entities to make disclosures for retail investors. Any legislation should require additional studies to understand how vulnerable communities interact with these markets and any potential abuses taking place.

The CFTC is the only regulator that relies entirely on appropriated funding from Congress. For any regulator taking on new authority, it is imperative that Congress provide sufficient resources to address these authorities.

Discussion

Thompson (R-PA): Why is it important for Congress to close these regulatory gaps? Is the CFTC capable of adapting to the new remit created by this bill? *Behnam:* We have seen increased retail participation to commodity cash markets, and this is particularly prevalent in the digital asset space. Bitcoin and ether make up 60 percent of digital asset markets, and at least bitcoin is a commodity. I have been vocal in the past that ether is a commodity. This bill would help address the gaps for these markets. The CFTC has shown in the past that it can take on significant new markets such as swaps markets. The CFTC has proven to be one of the most efficient regulators in the world.

Scott (D-GA): What would be the effect of not providing any new resources to implement the proposals in this bill? How long would this joint rulemaking process between the SEC and CFTC take? *Behnam:* I appreciate you highlighting this point. We would not be able to appropriately implement this law without additional resources. It is always difficult to estimate timing for joint rulemakings, but without additional funding, it would likely take upwards of three to four years. Provisional registration would hold the CFTC back and prevent us from using our existing authorities, which are limited and focused on fraud and manipulation. I think there is a more efficient way to address this issue, and I would take guidance from the process surrounding the implementation of swap markets provisions after Dodd-Frank. I think that the provisional period should begin after we have created the rules called for in the bill.

Scott (R-GA): Have you done studies on how you would handle registering the thousands of cryptocurrencies? How do you determine when a token is a commodity, and how do you prevent manipulation? *Behnam:* We have estimated resource needs, and I believe it would require about $120 million over three years. This would allow us to register exchanges, brokers, and

custodians. We focus on bitcoin and ether most commonly, but there are dynamics that would allow for many other tokens to be considered commodities. The vast majority of crypto tokens have almost no trading taking place, so we really do not need to concern ourselves with every token. The vast majority of trading is occurring on about a dozen tokens, some of which are commodities.

Costa (D-CA): What have we learned from the collapse of FTX? What are the concerns that these markets have for the financial system? *Behnam:* It should be noted that LedgerX was one of the only entities to survive the FTX collapse, and it was regulated by the CFTC. If these markets grow to the sizes that they have in the past without new regulations, I think that there are real financial stability concerns.

Crawford (R-AR): Can you speak to how LedgerX was regulated? What would the role of the National Futures Association (NFA) be under this new regulatory environment? *Behnam:* LedgerX has been licensed with the CFTC since 2017, and after it was acquired by FTX, they applied to offer margined contracts in a non-intermediated model. We have a great relationship with NFA, and we would certainly need a self-regulatory organization (SRO) to implement this regulatory scheme. We would need to understand how we would implement this model and whether we would allow already-registered designated contract markets (DCMs) to offer digital assets.

Brown (D-OH): How would the spending cuts Republicans have called for in their budget impact the CFTC's ability to regulate digital asset markets? *Behnam:* Our current budget request is for $411 million, and the recent proposal from the budget Committee would appropriate the CFTC $345 million, a $20 million cut from our current funding. Given our responsibilities and growing engagement from retail market participants, we believe that these cuts would be devastating to the CFTC. The CFTC returns $8 to Treasury for every dollar it is appropriated, so I believe that we are a good investment for the American people.

Brown (D-OH): What are the concerns surrounding climate and crypto? *Behnam:* The industry is already starting to address the climate

implications of mining, but there is more that could be done. Congress should consider including studies in any legislation for this space or creating more disclosures.

Bost (R-IL): What are the requirements for futures commission merchants (FCMs) surrounding disclosures? *Behnam:* There are many disclosures that FCMs apply, but the disclosures made for derivatives and commodity markets are around risk of loss and contract specifications.

Caraveo (D-CO): What do you believe is missing from this legislative draft? *Behnam:* I have concerns over the provisional registration regime proposed in the bill. I also have real concerns around funding. We also need to ensure that we are providing appropriate educational resources for communities that might be particularly vulnerable to manipulation in these markets. That said, I think this bill does address core structural issues in these markets.

Johnson (R-SD): What are your views on the views that are voiced in Congress that there is nothing to be done by Congress because the SEC already has the authority it needs to regulate these markets? What are your views on the Howie test provisions in this draft? Are you comfortable with the approach this bill takes to creating new classifications for digital asset market participants instead of trying to fit them into the existing regulatory scheme? *Behnam:* This is not a zero-sum game where either the CFTC or SEC take over crypto regulation. There is a gap in regulation between the CFTC and SEC that this bill addresses. I agree the SEC has authority over digital asset securities, but it is unquestionable that there are digital asset commodities that they have no authority over. I believe that the foundations of this bill are strong, but it will likely require more thought and some tweaks. I think in time we will learn how traditional assets can coincide with digital assets, but I think the approach of creating new buckets for them makes sense at this time.

Salinas (D-OR): What are regulators doing today to protect investors and what should the role of different regulators be going forward? *Behnam:* From a market regulatory perspective, we have either commodities or securities. At least one token, bitcoin, has been unquestionably classified

as a commodity, and I believe other tokens are commodities as well. This creates a gap that puts investors at more risk. I am proud of what we have accomplished even with this gap, but I believe we need to address these gaps if we are going to have real investor protections.

Baird (R-IN): How should funds be segregated in the crypto space? What is the role of the NFA in this framework? *Behnam:* Customer funds are sacrosanct in the CFTC landscape. This bill largely mimics the customer segregation regime that we have for our current markets for digital asset markets, and I think that provides vital customer protections. NFA is the CFTC's boots on the ground. They are invaluable in our regulatory work. An SRO like the NFA is a necessity for regulating markets such as these.

Budzinski (D-IL): Should the CFTC and SEC consider financial inclusion as they implement a regulatory framework for digital assets? *Behnam:* We are doing everything we can to disseminate educational tools to vulnerable communities that might be targeted by illicit schemes in these markets. We also are considering whether these industries are living up to their goals of benefitting unbanked communities. It is easy to see how these instruments could be useful tools for these communities, but they come with risks as well.

LaMalfa (R-CA): What are the parallels between these markets and the markets the CFTC currently regulates? *Behnam:* We would like to create a close parallel for these markets and our current futures markets. This comes with disclosures, conflicts of interest rules, customer segregation rules, and AML and KYC considerations. I think that our current regulations would work for this industry, but we would need to make some tweaks to ensure that they work for digital assets. We would work well with NFA on addressing these issues.

Jackson (D-IL): How are deposits assured under the CFTC regime? What is the current transparency under the CFTC regime? *Behnam:* FCM's have relationships with banking entities or custodians, and we get daily reports about customer funds and balances to ensure that assets are where they are supposed to be. We have transparency in order books to ensure that settlement is fully transparent.

Lucas (R-OK): Why should any legislative proposal be consistent with current securities laws and the Commodity Exchange Act? How are the SEC and CFTC currently collaborating on these issues and how will this legislation help? *Behnam:* These regulatory structures provide clarity and certainty, and any new regulatory regime should apply these time-tested methods. We work closely with the SEC on digital asset issues and have for almost a decade. If there is a futures contract regulated by the CFTC, I have to focus on the underlying commodities. I have been vocal that bitcoin and ether are commodities. Thus far, nobody has tried to list any other futures contract, but this legislation could potentially create a clearer path for contracts on more tokens to be listed.

Hayes (D-CT): How do you hold bad actors accountable in this space? *Behnam:* So much of this market remains unregulated. We have great concerns about things like kiosks and crypto ATMs taking advantage of vulnerable investors. Our enforcement authority is very limited currently, but we have still been hugely successful at bringing enforcement cases in this space.

Mann (R-KS): What did the CFTC learn from the expansion of its authority under Dodd-Frank? *Behnam:* The CFTC was efficient and successful in bringing transparency and order to swaps markets. We know that we will need additional resources to accomplish these with digital asset markets.

Moore (R-AL): How can we regulate these markets in a safe way without inhibiting innovation? *Behnam:* We have a principles-based regulatory scheme that provides strong investor regulations while allowing for flexibility and innovation.

Rose (R-TN): Is ether a commodity or a security? Is there currently a path to compliance at the CFTC unlike the SEC? *Behnam:* I believe ether is a commodity, and we have futures contracts listed on it. Given the legal precedent, I have faith that the decision to allow ether to be listed was correct. There is a pathway to be registered for derivatives with the CFTC for both incumbents and new exchanges.

Crockett (D-TX): What would be the impact of this bill being passed with the CFTC having its funding drop? *Behnam:* It would be devastating to the

agency. We are the only financial regulator without a user fee system, and this has proven to be a huge challenge to the agency. Congress should consider a user fee-based system for the digital assets industry.

De La Cruz (R-TX): At which point does a token move from a security to a commodity? *Behnam:* You could have an initial promoter of a token, but, if this token becomes so decentralized that the issuer no longer controls the token, it could move to a commodity.

Nunn (R-IA): Is ether a security or commodity? Do you think the SEC is picking winners and losers in this space? *Behnam:* We determined it is a commodity based off of the Howie test. With any of these tokens, they can be used in many different ways. I believe that a lack of regulatory clarity is hurting this industry and investors.

PANEL II SUMMARY

Opening Statements and Testimony

Christopher Giancarlo, Former Chairman, CFTC

The original decision to allow bitcoin futures was controversial, but not doing so would have only kept American companies from innovating and Americans from having access to the investments they wanted. This bill addresses public interest by closing regulatory gaps and providing new investor protections. These technologies are not going away, and we need to encourage innovation in this space. The CFTC is the right regulator to take on these spot markets.

Paul Grewal, Chief Legal Officer, Coinbase

Coinbase has always embraced regulation, and we are proud of our investor protections. We are disappointed but not surprised that the SEC decided to bring legislation against us the day that we are set to testify on proper regulation. The SEC's work has only hurt companies most dedicated to regulatory compliance.

This bill is a strong step forward to creating better regulatory clarity. This draft builds on existing successful precedent while considering some of the unique aspects of digital assets. Specifically, we are glad that the bill bases

CFTC regulations for digital assets off of existing CFTC regulatory structures. We are also supportive of provisions that would allow for side-by-side trading of digital commodities and securities. The bill also establishes a clear principles-based approach to disclosure obligations for digital asset securities that accommodates the realities of this industry. We are fully in support of this regulation.

Dan Gallagher, Chief Legal Compliance Officer, Robinhood, Former Commissioner, Securities and Exchange Commission (SEC)

The reality is that market participants currently face a patchwork of inconsistent state frameworks and a lack of clarity at the federal level.]For too long, the digital asset space has had to contend with stifling uncertainty, and this bill does much to finally bring clarity to these markets. Specifically, we believe that the industry would benefit from this discussion draft's treatment of digital asset intermediaries. We believe that Congress should consider addressing the SEC's recent staff accounting bulletin that requires that customer digital assets custodied by a broker-dealer be recorded as liabilities on the broker-dealer's balance sheet.

Dan Berkovitz, Former Commissioner, CFTC, Former General Council, SEC

Digital assets have the potential to transform the availability and scope of financial services. However, certain of these unregulated markets are operating in a manner that poses undue risks to investors. Neither the CFTC nor the SEC currently has regulatory authority over cash markets for non-security digital assets. This gap needs to be closed. This legislation should provide the CFTC with authority over these markets and intermediaries in these markets. This legislation also does not take any authorities away from the SEC, and any legislation should maintain the SEC's ability to enforce securities laws for digital securities. The CFTC should be provided with additional resources to take on these markets.

Walt Lukken, President and CEO, Futures Industry Association (FIA), Former Chairman, CFTC

The Commodity Exchange Act allows for significant innovation and flexibility to take on new asset classes. The principles-based approach that

the CFTC uses allows for this flexibility and innovation to foster, but the CFTC is not a light-touch regulator and should not be regarded as such. We believe that CFTC regulations would apply well to digital assets, and the CFTC and NFA have proven their ability to mitigate fraud and abuse risks through their regulation and enforcement tools.

Discussion

Feenstra (R-IA): What is the value and potential of digital asset commodities? How would this legislation help innovation in this space? *Giancarlo:* Beyond their simple market value, these assets demonstrate a new architecture for finance and banking. Current architecture is slow, expensive, and has the potential to be manipulated. This new innovation has untold value by changing the way we store value and information. This legislation allows this innovation to foster and establishes a consumer protection framework; *Lukken:* The CFTC promotes innovation, and principles-based regulation allows for these markets to evolve in a safe way; *Grewal:* This legislation relies on existing regulations which tells investors that we are using a framework that has always worked.

Scott (D-GA): Do the CFTC and SEC have enough funding to take on these responsibilities? *Lukken:* The CFTC needs additional funding to take on these markets. The NFA will also be a big part of this regulation, and it will be operating off of fees; *Berkovitz:* I believe that Chairman Behnam's request for $120 million over three years would be a minimum amount.

Lucas (R-OK): Do the CFTC and SEC work well together? How is it more difficult to create a regulatory regime if the U.S. is behind other jurisdictions? *Giancarlo:* I think it is possible, but it has historically not been a particularly productive working relationship. That said, the two have worked successfully together in the past; *Lukken:* If the U.S. falls behind, it will need to accept standards established by other jurisdictions because these are global markets. We want to establish standards based on our values; *Giancarlo:* We must stamp American values onto international standards.

Caraveo (D-CO): Is there anything missing from this legislation? *Gallagher:* This is sound legislation, but Congress should consider being more prescriptive; *Berkovitz:* The CFTC is designed for wholesale markets, and Congress should consider applying certain considerations for retail investors. Some of this could be taken from SEC regulations.

Rose (R-TN): If tokens are considered securities, could you offer them through an SEC registered broker-dealer platform? Does the SEC need more authority to regulate crypto? *Gallagher:* The answer is no, which points to the inconsistencies in this whole system. The current SEC frameworks makes this impossible because it makes requirements of issuers that we cannot achieve; *Berkovitz:* The statutory authority of securities laws is sufficient for digital assets, but there is a regulatory gap; *Grewal:* Under current SEC regulation, we are told to come in and register, but the SEC makes this impossible.

Johnson (R-SD): Is the current SEC disclosure regime well suited for digital assets? Is the CFTC regulatory structure well suited for these markets? *Gallagher:* The current framework is tailored to securities. I also am firmly opposed to the notion that most crypto tokens are securities. Current SEC disclosures do not tailor well to digital assets, but this bill does a good job at setting up an appropriate disclosure regime; *Berkovitz:* The CFTC regime is adequate to protecting those in its markets, but it would not work for securities markets, so any legislation must be careful to not put anything that should be under SEC jurisdiction under the CFTC; *Lukken:* The principles-based system is not light touch; it is just flexible.

Soto (D-FL): How would you define a digital asset? *Giancarlo:* When looking at cryptocurrencies, it is important to look at the underlying blockchain. These tokens can serve many different functions. In this sense, they can be commodities, securities, or serve with a banking function. There really is no single box to put these tokens in.

Molinaro (R-NY): How can you prove decentralization for a token? Has the CFTC done a good job in improving the swaps market through regulation? *Giancarlo:* I believe that these questions should be left to the

CFTC and the SEC; *Berkovitz:* The CFTC absolutely improved transparency and resiliency in the swaps market.